

BEFORE  
THE PUBLIC SERVICE COMMISSION OF  
SOUTH CAROLINA

DOCKET NOS. 2002-367-C & 2002-408-C - ORDER NO. 2003-656

OCTOBER 31, 2003

IN RE: ✓ <b>Docket No. 2002-367-C</b> – Generic Proceeding	)	ORDER ON ✓
to Address Abuse of Market Position	)	“INFLATION-BASED
	)	INDEX” AND “ABUSE
AND	)	OF MARKET
	)	POSITION”
<b>Docket No. 2002-408-C</b> – Generic Proceeding	)	
to Address Inflation Based Index	)	

**I. INTRODUCTION**

This matter comes before the Public Service Commission of South Carolina pursuant to a joint hearing held on two dockets related to South Carolina Code Ann. Sections 58-9-576(4) and (5)(Supp. 2002), respectively, related to the proposed definitions of the terms “inflation-based index,” and “abuse of market position.”

The Code sections relevant to this proceeding read as follows:

- (3) The rates for flat-rated local exchange services for residential and single-line business customers on the date of election shall be the maximum rates that such LEC (local exchange carrier) may charge for these local exchange services for a period of two years from the date the election is filed with the commission. During such period the local exchange company may charge less than the authorized maximum rates for these services. For those small LEC’s whose prices are below the statewide average local service rate, weighted by number of access lines, the commission shall waive the requirements of this paragraph.
- (4) For those companies to which item (3) applies, after the expiration of the period set forth above, the rate for flat-rate

local exchange residential and single-line business service provided by a LEC may be adjusted on an annual basis pursuant to an inflation-based index. (emphasis added).

- (5) The LEC's shall set rates for all other services on a basis that does not unreasonably discriminate between similarly situated customers; provided, however, that all such rates are subject to a complaint process for abuse of market position in accordance with guidelines to be adopted by the commission. (emphasis added).

Both Dockets were established subsequent to a request and/or complaint filed by the Consumer Advocate for the State of South Carolina (the Consumer Advocate). In Order No. 2003-82, we established the generic docket to consider a definition of "inflation-based index," subject to a request of the Consumer Advocate. In Order No. 2002-679, we established a generic proceeding to consider the definition for "abuse of market position" and to consider criteria for determining whether various behaviors by companies regulated pursuant to Section 58-9-576 constitute "abuse of market position." This Order was issued pursuant to a complaint filed by the Consumer Advocate. The matters were consolidated for hearing purposes pursuant to Order No. 2003-124.

Pursuant to the instructions of the Commission's Executive Director, Notices of Filing were published one time in newspapers of general circulation. With regard to the "inflation-based index" Docket, Petitions to Intervene were received from the Consumer Advocate, Verizon South, Inc. (Verizon), and MCI-MCIMetro. With regard to the "abuse of market position" Docket, Petitions to Intervene were received from the Consumer Advocate, United Telephone of the Carolinas (United), BellSouth Telecommunications, Inc. (BellSouth), the Competitive Carriers of the Southeast, Inc. (the Competitive

Carriers or Comp. South), Verizon South, Inc., Alltel South Carolina, Inc. (Alltel), and MCI-MCIMetro.

A consolidated hearing was held on the matters on August 13, 2003 at 10:30 AM in the offices of the Commission. The Honorable Mignon Clyburn, Chair, presided. The Commission Staff was represented by F. David Butler, General Counsel. The Consumer Advocate was represented by Elliott F. Elam, Jr., Esquire. MCI-MCIMetro was represented by Darra W. Cothran, Esquire and Ken Woods, Esquire. The Competitive Carriers were represented by John J. Pringle, Jr. Verizon was represented by Steven W. Hamm, Esquire. United was represented by Scott Elliott, Esquire, and H. Edward Phillips, Esquire. Alltel was represented by Robert D. Coble, Esquire. BellSouth was represented by Patrick W. Turner, Esquire.

At the hearing, the Commission Staff presented the testimony of James E. Spearman, Ph. D. The Consumer Advocate presented the testimony of Allen G. Buckalew. MCI-MCIMetro presented the testimony of Greg Darnell. Dennis B. Trimble presented direct and reply testimony on behalf of Verizon. United presented the direct and reply testimony of Brian K. Staihr. Alltel presented the direct and reply testimony of Jayne Eve. Finally, BellSouth presented the direct and reply testimonies of John A. Ruscilli and William E. Taylor.

## **II. MOTIONS**

CompSouth presented two Motions for consideration by this Commission at the time of the hearing. First, CompSouth moved to dismiss the cases under SCRCF 12(b)(6) for failure to state a cause of action. This was later converted to a Motion for Summary

Judgment at the close of Staff's case. TR. 171. Second, CompSouth made a motion in limine to exclude all evidence having to do with current market shares or current customer loss of any local exchange carriers (LECs) in the proceeding. TR. 318. We deny both Motions.

First, counsel for CompSouth argues that, because there are no rates, practices, or charges before this Commission for determination, that the case on "abuse of market position" should be dismissed, pursuant to SCRCF 12(b)(6). TR. 14. According to CompSouth's counsel, there are no claims or issues upon which relief can be granted, and no facts to be decided. In support of the converted Motion for Summary Judgment, counsel argues that there is no material issue of fact before this Commission, and that, as a matter of law, the matter should be dismissed, because of a lack of a case or controversy. TR. 171. We disagree. As shown in the introduction to this Order, this Commission must decide how to proceed to define the term "abuse of market position," as used in the statutory law. Witnesses in the present case have presented a considerable amount of evidence and have given their varied ideas as to how we should define this term. Examination of how to define "abuse of market position" must be done by examining the facts before this Commission, even though the "facts" in question are various scientific and economic theories. These various scientific and economic theories constitute sufficient "facts" before the Commission to avoid dismissal of the case pursuant to SCRCF 12(b)(6) and to avoid the granting of summary judgment. We therefore deny this motion.

Second, we deny the motion in limine, which, if granted, would exclude all evidence having to do with current market shares or current customer loss of any LECs in this proceeding. Counsel for CompSouth argues that such information is not relevant to the determination of the definition of “abuse of market position.” TR. 318. BellSouth argued at the hearing that this information was market information, and, as such, was clearly relevant. TR. 318-319. United concurred in this argument. TR. 320. We agree that the information sought to be excluded on current market shares or current customer loss is relevant to a determination of what constitutes “abuse of market position.” Accordingly, the motion in limine is denied.

### **III. INFLATION-BASED INDEX**

The parties presented voluminous testimony on the subject of what “inflation-based index” this Commission should approve for purposes of the statute.

The testimony of Staff witness Spearman is significant in this area. Spearman testified that, as a general rule, there are three indices that are used to measure inflation: the Consumer Price Index (CPI), the Producer Price Index (PPI), and the Gross Domestic Product price deflator (GDP-Deflator). The CPI is sometimes referred to as the retail price index or the cost-of-living index. The PPI is often referred to as the wholesale price index. TR. 53.

According to Dr. Spearman, the CPI measures inflation as experienced by consumers in their daily living expenses and measures the price increase for a basket of domestic and imported goods and services purchased for personal consumption by urban households. The CPI does not, however, capture the changes in buying or consumption

patterns that consumers make in response to relative price changes in goods and services nor does the CPI account for quality changes in goods and services. The CPI is considered an upper bound for inflation. TR. 53-54.

The PPI measures changes in the selling prices received by domestic producers of goods and services. The target set of goods and services is the entire marketed output of U.S. producers; imports are excluded. Dr. Spearman does not recommend that the PPI be used as an inflation-based index for the purpose defined in the statute, because the telecommunications industry has a large service component that is not captured by the PPI. Further, because the PPI is a measure of input prices, it does not reflect productivity impacts on the prices consumers pay for finished goods and services.

The GDP-Deflator combines the inflation experienced by governments, businesses, and consumers. According to Dr. Spearman, the GDP-Deflator is perhaps the most inclusive of all price indices. Spearman testified that a recent improvement to the GDP-Deflator has been the development of the chain-type indices. The chain-type price index is an attempt to compensate for improvements in product quality and the changes in consumption pattern in response to relative price changes. The chain-type price deflator is virtually identical to the standard GDP-Deflator which is generally called the implicit price deflator. TR. 58. Spearman testified that if the Commission desires an inflation-based index that includes both a producer and a consumer component, the GDP-Deflator would be appropriate. Further, the GDP-Deflator is a combination of producer (wholesale) prices and consumer (retail) prices. The GDP-Deflator also attempts to

incorporate changes in quality and changes in consumption patterns into its price index, according to Dr. Spearman. TR. 61.

Dr. Dennis Trimble testified that an “inflation-based index” means an index that is based on a measure of inflation as opposed to an index that is based on a measure of costs, a measure of productivity, or a measure of some other factor. TR. 275. Both Dr. Trimble and BellSouth witness Dr. William E. Taylor recommend that this Commission establish either the fixed-based form or the chain-type form of the GDP-PI as the inflation-based index under the statute. Id.; TR. 736-737. Dr. Taylor notes that the chain-type form of the GDP-PI is equivalent to the GDP-Deflator recommended by Dr. Spearman. Id. Dr. Taylor testified that an index like the GDP-PI pertains to the general economy, rather than to any specific market, sector, or industry, which is consistent with the preference expressed by the FCC. Dr. Taylor further noted that the GDP-PI has been specifically chosen by the FCC as the appropriate measure of inflation to use in relation to telecommunications matters. BellSouth’s Brief at 4-5.

Dr. Taylor also testified that the GDP in general is more appropriate to use in this context than the CPI or PPI. According to Dr. Taylor, the GDP avoids some of the selectivity problems of the CPI. Further, since the GDP-PI is not constrained by the stage of production or consumption, it is a more appropriate inflation-based index than the PPI, which serves better as a measure of inflation for wholesale goods and services. TR. 743.

In addition, administrative efficiency supports the establishment of the GDP-PI as the inflation-based index. Dr. Taylor explained that, unlike other measures of inflation that were discussed during the hearing, the GDP-PI is published quarterly and annually

by the U.S. Department of Commerce's Bureau of Economic Analysis. Id. Also, Staff witness Spearman agreed that determining the value of the GDP-PI is simple because the values are available on the Internet. TR. 108.

Dr. Spearman and other witnesses testified that if a GDP-Deflator (and, therefore, the GDP-PI) was used as the inflation-based index, no productivity adjustment would be appropriate. According to Dr. Spearman, the prices at which goods and services are purchased by consumers already include the impacts of productivity. Further, the productivity of the telecommunications industry is difficult to measure, also according to Dr. Spearman. TR. 60.

This is in direct contrast with the testimony of Consumer Advocate witness Allen Buckalew. Buckalew asserts that, pursuant to the FCC's LEC Price Cap Order, an "X-factor" or productivity factor should be subtracted from the inflation-based index. TR. 184. Under Buckalew's theory, the productivity factor reflects the amount by which LEC productivity gains are expected to exceed productivity gains in the economy as a whole. TR. 185. The productivity offset which is subtracted from the inflation factor reflects the amount by which telephone companies' productivity gains are expected to exceed productivity gains in the economy as a whole, according to Buckalew. TR. 187. Buckalew states that the FCC and every state of which he is aware uses an inflation-based index minus a productivity factor. Specifically, Buckalew notes that Alabama, Connecticut, Utah, Iowa, and Pennsylvania all have price cap plans that incorporate both inflation and productivity factors. TR. 191. Buckalew summarizes his recommendation by stating that he believes that this Commission should implement an inflation-based



index that limits price increases/decreases for telecommunications services using a formula which consists of an inflation factor minus a productivity factor of 2% to 3%. Buckalew finally stated that he did not believe that utilizing the CPI or GDP-Deflator without a productivity factor will adequately measure a telephone company's actual changes in costs to provide service in South Carolina. TR. 103-104.

Unfortunately, Mr. Buckalew is alone in his conclusion that a productivity factor is needed. Other parties, including the Commission Staff as noted above, state opposing views. Verizon witness Dennis B. Trimble testified that, with the release of the CALLS Order in 2002, the FCC moved away from a productivity offset factor. TR.288. Further, Verizon operates in 28 states and the District of Columbia, and Verizon reports that only 6 states still have an inflation-based index and a productivity factor. Id. Alltel witness Jayne Eve notes that the applicable statute does not provide for a productivity offset, noting that S.C. Code Ann. Section 58-9-576 (B)(4) only calls for an inflation-based index. TR. 416. Ms. Eve states that had the Legislature had contemplated an adjustment for productivity, it would have expressly provided for such an adjustment. TR. 417. Ms. Eve reasons that the statute does not provide for a productivity offset, so the Legislature's directive to the Commission is clear. Id. Ms. Eve also notes that market changes have made the productivity factor recommended by Buckalew obsolete and inappropriate. TR. 418.

BellSouth witness Ruscilli agrees that the South Carolina statute does not contemplate the use of a productivity factor when considering the inflation-based index. TR. 492. Ruscilli cites specific examples of states with statutes that specifically allow the

use of the productivity factor. Ruscilli argues that because the South Carolina statute does not allow for the productivity factor, one should not be used. TR. 492-495.

BellSouth witness William E. Taylor also opposes the adoption of a productivity factor by this Commission. First, Dr. Taylor notes that Buckalew is describing an outdated plan from the FCC. The “X-Factor” is no longer based on any estimate of potential LEC productivity growth relative to the economy but is an explicit device to reduce carrier access charges to prespecified levels by the end of the plan. TR. 795. Dr. Taylor also notes that X-Factors are, if anything, overly ambitious expectations for the prospects of further LEC retail price decline. TR. 797. In addition, Dr. Taylor testified that recent changes to price cap plans tend to reduce or eliminate productivity offsets in recognition of the fact that competition can control prices of at least some telecommunications services more efficiently than regulation. TR. 803-804. Considering the reasoning of witnesses Spearman, Trimble, Eve, Ruscilli, and Taylor, we reject establishment of the productivity factor as proposed by the Consumer Advocate. We believe that these witnesses state ample reasons why the concept of a productivity factor should be rejected.

Based on the reasoning and testimony of the above-quoted witnesses, we adopt the GDP chain-type index known as the GDP-PI without a productivity adjustment as the “inflation-based” index under Section 58-9-576(B)(4). We find that the GDP chain-type index known as the GDP-PI is the best index available for purposes of the statute, based on the reasoning as elucidated above. Further, we hold that the statute does not provide for use of a productivity factor nor does economic policy necessitate it.

#### **IV. ABUSE OF MARKET POSITION**

The parties presented excellent testimony in the area of “abuse of market position.” Because of the voluminous nature of the testimony, we decline to discuss the testimony of each witness in detail; however, we will discuss certain specifics of the testimony.

We would note that Dr. James E. Spearman, the Staff witness, originally defined “abuse of market position as “[a]ny action that effectively prohibits a new firm from entering a market.” TR. 42. Dr. Spearman testified that, though the statute uses the word “position” instead of “power,” the two words must be used interchangeably to give the statutory phrase any meaning. TR. 41.

During cross-examination, Dr. Spearman agreed to two modifications of his original definition. First, he agreed that “any action” could be modified to read “any action that the Commission finds to be anticompetitive.” TR.110. Second, Dr. Spearman also agreed that the definition should cover not only actions that prohibit a new firm from entering a market, but also cover actions that cause a firm to exit a market. TR. 147. Both of these modifications have a basis in sound reasoning. The first modification is appropriate because not all actions that prohibit a firm from entering a market harm competition. For example, a potential competitor might not enter the market because it is relatively inefficient and that competitor could not compete at the non-predatory prices being offered by the firms in the market. TR. 438. The second modification is also appropriate because anticompetitive conduct that prevents new firms from entering a market or that causes firms to exit a market could be an abuse of market position.

To summarize, Dr. Spearman's position after cross-examination is that "abuse of market position" should refer to "any anticompetitive action that prohibits a new firm from entering a market or that causes a firm to exit a market." Put even more succinctly, as Dr. Spearman states, "an abuse occurs if there is an attempt to eliminate competition." TR. 103. This definition is somewhat similar to that proposed by BellSouth. BellSouth's proposed definition is "any anticompetitive pricing conduct that harms the competitive process." This is consistent with the positions of all of the parties, save one, that apparently agree that "abuse of market position" means "anticompetitive conduct that harms the competitive process." TR 284. For this reason, we believe that "conduct" should be added to Dr. Spearman's definition of "abuse of market position."

As BellSouth notes in its Brief in this case, both Dr. Spearman and BellSouth refer to "action" or "conduct." We agree that merely possessing market power (or market position) is not illegal. Rather, it is using that market power in an inappropriate way, i.e. an abuse, that is illegal under the statute. Post-Hearing Brief of BellSouth at 21. See also testimony of United witness Staihr at 346.

Accordingly, based on this testimony, at this time, we hold that "abuse of market position" will be defined as "any anticompetitive action or conduct that prohibits a new firm from entering a market or that causes a firm to exit a market." We further hold that our use of the terminology "at this time" recognizes that this definition could change and evolve as this Commission hears actual cases related to "abuse of market position."

We would further note that Dr. Spearman testified that he did not believe that this Commission can establish criteria or determine that a particular activity by a company is

per se an abuse of market power. We would note that the parties presented many different scenarios as to what they believed was and was not an abuse of market position. Dr. Spearman points out that the Telecommunications Act and the resulting Federal Communications Commission rulings and various court rulings have removed the obvious criteria or activities that would be considered per se abuses of market power. Accordingly, Dr. Spearman concluded that the Commission must consider allegations of abuse of market power on a case by case basis. TR. 48.

Based on this testimony, we will not attempt to establish specific criteria or guidelines at this time nor will we make a specific determination of what is and what is not an “abuse of market position.” However, we will, as suggested by Dr. Spearman, consider allegations of “abuse of market position” on a case by case basis. See also testimony of MCI witness Darnell at 223-224. The record does not support a specific checklist or specific criteria to determine whether a particular activity is or is not per se “abuse of market position.” We hold that an evidentiary hearing will need to be conducted in each case, and the allegations of each case must be determined on the facts presented.

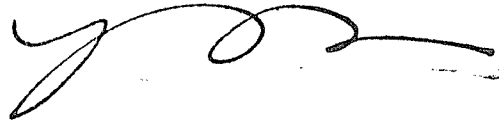
## **V. CONCLUSION**

In conclusion, we hereby adopt the GDP-PI without a productivity factor as the inflation-based index under Section 58-9-576(B)(4). As of this time, abuse of market position will be defined as any anticompetitive action or conduct that prohibits a new firm from entering a market or that causes a firm to exit a market. Allegations of abuse of market position will be considered on a case by case basis. No specific guidelines on

abuse of market position will be established at this time. The definition of abuse of market position could change and evolve as this Commission hears actual cases related to the subject.

This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:



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Mignon L. Clyburn  
Chairman

ATTEST:



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Bruce F. Duke  
Deputy Executive Director

(SEAL)